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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 579

CHARLES ILFELD COMPANY, PETITIONER

v.

B. C. HERNANDEZ, COLLECTOR OF INTERNAL REVENUE for the District of New Mexico

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

No written opinion was rendered by the District Court. Its findings of fact and conclusions of law appear at R. 19–24. The original opinion of the Circuit Court of Appeals (R. 111–120) is reported in 66 F. (2d) 236. An opinion rendered on a petition for rehearing (R. 124–129) is reported in 67 F. (2d) 236.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 13, 1933. (R. 120–121.) A peti-

tion for a rehearing was filed August 10, 1933 (R. 121–124), and was denied October 10, 1933 (R. 129). The petition for a writ of certiorari was filed November 10, 1933, and was granted December 18, 1933. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner was affiliated with two subsidiary corporations through ownership of all of such corporations' stock during the year 1929 and for some years prior thereto. During the year 1929, up to and including the month of November, 1929, the subsidiary corporations liquidated and sold all of their assets to outside interests and in December, 1929, turned over to the petitioner the cash proceeds realized from liquidation. Such cash proceeds were less in amount in each case than the cost of the subsidiary's stock to the petitioner, plus advances theretofore made by the petitioner to the subsidiary. During the period of affiliation the petitioner was enabled through the medium of consolidated returns to deduct from its income losses of the subsidiaries exceeding in amount the difference between the cost of the stock plus advances made and the amounts received on liquidation. Was the petitioner entitled to deduct any amounts from its income for 1929 as a result of the liquidation of the subsidiaries?

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved will be found in Appendix A, *infra*, pp. 28–37.

STATEMENT

The petitioner brought this suit in the District Court for New Mexico for the recovery of income taxes paid for the year 1929. (R. 1–4.) Jury trial was waived in writing (R. 11) and the court made findings of fact and conclusions of law (R. 19–24). The facts found may be summarized as follows:

The petitioner purchased all of the capital stock of the Springer Trading Company in 1917 and all of the capital stock of the Roy Trading Company in 1920 and operated both corporations as affiliated or subsidiary corporations from the dates of such purchases up to and including the month of November, 1929. During the years of such operation the petitioner filed consolidated returns and availed itself of the annual operating losses of the subsidiaries during the period of affiliation. (R. 19–20.)

The petitioner paid the sum of $40,000 for the Springer Trading Company stock and during the period from 1917 to 1929 advanced and loaned to the latter company the sum of $69,030.27. During the year 1929, up to and including the month of November, the Springer Trading Company liquidated and sold all of its assets to outside interests and paid all of its obligations. In December, 1929, the

Springer Trading Company turned over to the petitioner the cash proceeds derived from liquidation in the sum of $22,914.22. The petitioner sustained a loss on its capital investment in the Springer Trading Company in the sum of $86,116.05, which was charged off the petitioner's books as a loss at the close of the year 1929. (R. 20–21.)

The petitioner paid the sum of $50,000 for the Roy Trading Company stock and during the period from 1920 to 1929 advanced and loaned the latter company the sum of $9,782.22. During the year 1929, up to and including the month of November, the Roy Trading Company liquidated and sold all of its assets to outside interests and paid all of its obligations. In December, 1929, the Roy Trading Company turned over to the petitioner the cash proceeds derived from liquidation in the sum of $15,106.16. The petitioner sustained a loss on its capital investment in the Roy Trading Company in the sum of $44,676.06, which was charged off the petitioner's books as a loss at the close of the year 1929. (R. 21.)

Both the Springer Trading Company and the Roy Trading Company were liquidated and dissolved in the month of November, 1929.[1] (R. 21.)

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[1] The conclusion that the two corporations were dissolved in November, 1929, is not sustained by the record, unless by "dissolved" it is meant that the proceedings directed toward dissolution were initiated in November, 1929. The testimony at R. 52, relied on by the petitioner (Br. 3), must be read in connection with the immediately following testimony

The petitioner has claimed and been allowed, in the aggregate, as deductions from its own net income for the taxable years 1918 to 1928, inclusive, the total sum of $131,424.41, and charged with and taxed upon profits in the total sum of $12,913.88, or allowed aggregate net deductions from its own taxable net income of $118,510.53 on account of operating losses sustained by the Springer Trading Company. (R. 23.)

The petitioner has claimed and been allowed, in the aggregate, as deductions from its own net income for the taxable years from 1920 to 1929, inclusive, the total sum of $61,535.17, and charged with and taxed upon the profits in the total sum of $4,407.32, or allowed aggregate net deductions from its own taxable net income of $58,127.85 on account of operating losses sustained by the Roy Trading Company. (R. 23–24.)

In the year 1930, the petitioner filed its consolidated return covering its operations and those of the Roy Trading Company and the Springer Trading Company, without deducting the losses sustained by it on the liquidation and dissolution of the two subsidiaries, and paid to the Collector the

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of the same witness, which shows that the stock of both corporations was voted at stockholders' meeting held on December 30, 1929, and that dissolution occurred on that date. (R. 53–54.) See also the statement on the taxpayer's original return. (R. 72.) This finding of the District Court was assigned as error (R. 106), and this assignment was apparently sustained by the Circuit Court of Appeals. See R. 113.

sum of $20,836.20 in equal quarterly installments. (R. 22.) Thereafter, in May, 1931, the petitioner filed an amended return and claim for refund for the year 1929, setting up these losses as deductible. (R. 22.) The claim for refund was rejected by the Commissioner on January 28, 1932. (R. 22.)

The District Court rendered judgment for the petitioner for $14,460.43, with interest. (R. 25, 103.) The Circuit Court of Appeals held that capital losses resulting from the liquidation of the subsidiaries were items properly entering into the petitioner's return but that the loss already allowed having been in excess of the total losses sustained by reason of the purchase, operation, and liquidation of the subsidiaries, the judgment should have been for the respondent. (R. 111–120.) The court therefore reversed the judgment of the District Court but remanded the case for a new trial. (R. 120–121.) The petitioner thereupon filed a petition for rehearing contending that the case was ruled by the provisions of Treasury Regulations 75 applicable to 1929 and subsequent years. The Circuit Court of Appeals denied the petition and filed an opinion holding that the provisions of the regulations permitted the petitioner as parent to deduct losses realized on the winding up of the subsidiaries but neither the statute nor the regulations contemplated that the deduction should be taken twice. (R. 124–129.)

SUMMARY OF ARGUMENT

I

The petitioner is not entitled to deduct as a loss any portion of the amount by which the cost of its subsidiaries' stock and the advances to the subsidiaries exceeded the amounts received on liquidation, since under Regulations 75, which are applicable to the taxable year involved, the distributions to the petitioner constituted intercompany transactions upon which no gain or loss is recognized. The Commissioner originally took this position under Revenue Acts applicable to 1928 and prior years but later reversed it for such years, following this Court's decision in *Burnet* v. *Aluminum Goods Manufacturing Co.*, 287 U.S. 544.

For 1929 and subsequent years Congress granted to the Commissioner, with the approval of the Secretary, the power to prescribe regulations for the determination of the tax liability of an affiliated group in such manner as clearly to reflect the income and to prevent avoidance of tax liability, including the right to determine the extent to which gain or loss should be recognized upon the dissolution of a member of the group. Pursuant to this grant of power the Commissioner provided in Articles 37 (a) and 40 (a) of Regulations 75 (*infra*, p. 36) that gain or loss should not be recognized upon a distribution by an affiliate during a consolidated return period in cancellation or redemption

of all or any portion of its stock and that intercompany obligations should not be deducted as bad debts during a consolidated return period. The distribution in this case was made before affiliation ceased and was during a consolidated return period within the meaning of Regulations 75. Consequently no loss should be recognized.

These regulations control the question since they have the force and effect of law. They were properly made pursuant to express Congressional authority. They refuse to recognize gains equally with losses. Moreover, the petitioner and its affiliates had the right to elect whether or not they should file a consolidated return. By filing such return they accepted and were bound by the provisions of the regulations.

II

Even if the losses on liquidation are recognizable, the petitioner is not entitled to recover, since, as the court below held, it has received deductions from its income in previous years on account of losses of the subsidiaries exceeding in amount the losses now claimed. Through the medium of consolidated returns for prior years, the petitioner was enabled to deduct more than the actual loss on its whole investment. The operating losses of the subsidiaries in prior years were reflected in the eventual loss in the value of their stock and their accounts payable. While the statute provides generally for the deduction of losses incurred, neither

statute nor equitable principles of accounting contemplate that a loss may be deducted twice. The principle is applicable to the investment in the subsidiaries' stock as well as to the advances made.

The provisions of Articles 37 (b) and 34 (c) (2) of Regulations 75 (*infra*, pp. 36, 33) are not applicable here. They refer to a distribution after a consolidated return period and were not intended to apply to distributions such as those in this case, occurring while the corporations were still in existence and affiliated. But even if Article 34 (c) (2) could be held to apply, it is evident that there the Commissioner was only ruling with respect to the application of losses for 1929 and subsequent years. Regulations 75 were so limited. In prescribing regulations binding a taxpayer upon acceptance of their terms, there was no intention to restrict the taxpayer's right to raise a question of prior years' losses, not at that time authoritatively decided.

ARGUMENT

We contend that the deductions sought by the petitioner should not be allowed for two reasons: (1) Because the regulations applicable to the year involved, prescribed pursuant to express legislative authority, prohibit the recognition of such losses on liquidation, and (2) even if the losses are not prohibited altogether, they must be offset by deductions theretofore allowed the petitioner on account of operating losses of the subsidiaries which in this case exceeded the final losses claimed.

I

UNDER REGULATIONS 75, APPLICABLE TO THE TAXABLE YEAR 1929, THE DISTRIBUTIONS BY THE PETITIONER'S AFFILIATES CONSTITUTED INTERCOMPANY TRANSACTIONS UPON WHICH NO LOSS IS RECOGNIZED

The question whether in 1928 and prior years a parent corporation upon liquidation of a subsidiary was entitled to deduct as losses the cost of a subsidiary's stock, or the amount of advances and loans to the subsidiary, was productive of considerable litigation prior to the decision of this Court in *Burnet* v. *Aluminum Goods Manufacturing Co.*, 287 U.S. 544. While neither the statute nor the regulations were specific on the subject, the Commissioner took the position that the liquidation of a subsidiary constituted an intercompany transaction upon which no gain or loss should be recognized. Sol. Op. 131, I–1 Cumulative Bulletin 18, 23; G.C.M. 1501, VI–1 Cumulative Bulletin 260; G.C.M. 2774, VII–1 Cumulative Bulletin 196. The Board of Tax Appeals sustained this position in several cases and also held that gains as well as losses should not be recognized. *Appeal of United States Trust Co.*, 1 B.T.A. 901; *Mackechnie Bread Co.* v. *Commissioner*, 5 B.T.A. 883; *Wilmington Steamboat Co.* v. *Commissioner*, 9 B.T.A. 704; *Lau Co.* v. *Commissioner*, 15 B.T.A. 1064; and see *Utica Knitting Co.* v. *United States*, 68 C.Cls. 77, certiorari denied, 281 U.S. 739. Following the decision of this Court in the *Aluminum Goods Manufacturing Co.* case the administrative position was

changed and it was determined that losses as well as gains resulting from the liquidation of a subsidiary were to be recognized for 1928 and previous years. G.C.M. 11676, XII–1 Cumulative Bulletin 75.

The year 1929 marked a departure in the method of treatment of consolidated returns from that previously observed for 1928 and prior years. The Revenue Acts prior to that time had provided for such returns with a general power given to the Commissioner with the approval of the Secretary to prescribe regulations with respect thereto. Cf. Revenue Act of 1928, Section 142; Revenue Act of 1926, Section 240 (a). The Revenue Bill of 1928, as originally passed by the House, contained no provisions for consolidated returns for 1929 and subsequent years. This privilege was restored by the Senate but with the further provision that the Commissioner, with the approval of the Secretary, should have the power to prescribe such regulations as he might deem necessary in order that the tax liability of an affiliated group of corporations, making a consolidated return, might be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability. See S.Rep. No. 960, 70th Cong., 1st Sess., pp. 13–15.

It was further provided that the privilege of making a consolidated return should be upon the condition that all the corporations which were members of the affiliated group consent to all the regu-

lations so prescribed and that the making of a consolidated return should be considered as such consent. The House accepted the provisions inserted by the Senate (H.Rep. No. 1882, 70th Cong., 1st Sess., pp. 16–17), and they were enacted as Section 141 (a) and (b) of the Revenue Act of 1928 (*infra* pp. 28–29). The provisions with respect to the regulations were inserted in order to give the Commissioner the power to prescribe definite rules resolving many difficult problems arising in the administration of the provisions relative to consolidated returns. It was expected that the Commissioner would prescribe, among other things, the extent to which gain or loss should be recognized upon the dissolution of a member of the affiliated group.[2]

Pursuant to the authority so granted by Congress, the Commissioner with the approval of the Secretary promulgated Regulations 75, applicable to the year 1929 and subsequent years. The respondent, of course, agrees with the petitioner's

[2] The purpose of Congress in enacting Section 141 of the Revenue Act of 1928 is shown by the Senate Finance Committee Report, which states in part (S.Rep. No. 960, 70th Cong., 1st Sess., p. 15):

"Many difficult and complicated problems, however, have arisen in the administration of the provisions permitting the filing of consolidated returns. It is, obviously, of utmost importance that these questions be answered with certainty and a definite rule be prescribed. Frequently, the particular policy is comparatively immaterial, so long as the rule to be applied is known. The committee believes it to be impracticable to attempt by legislation to prescribe the various detailed and complicated rules necessary to meet the many differing and complicated situations. Accordingly, it has

contention that these Regulations are applicable, and are binding on the Government as well as the taxpayer. Our contention is that they in terms forbid recognition of the loss in this case. Article 37 (a) of the Regulations (*infra*, p. 36) provides that a distribution during a consolidated return period by one affiliate to another in cancellation or redemption of all or any portion of its stock shall be considered an intercompany transaction upon which gain or loss shall not be recognized. Article 40 (a) (*infra*, p. 36) provides that intercompany obligations which are the result of intercompany transactions during a consolidated return period shall not be deducted as bad debts during a consolidated return period. We submit that these two articles are directly applicable and prevent the allowance sought since the losses occurred during a consolidated return period.

The distributions were made to the petitioner on December 23, 1929. (R. 20, 21, 51.) While the District Court found that at that time the subsidiaries had suspended business and had ceased to function, the evidence shows beyond dispute that

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found it necessary to delegate power to the commissioner to prescribe regulations legislative in character covering them. * * *

"Among the regulations which it is expected that the commissioner will prescribe are: (1) The extent to which gain or loss shall be recognized upon the sale by a member of the affiliated group of stock issued by any other member of the affiliated group or upon the dissolution (whether partial or complete) of a member of the group; * * *."

See also H.Rep. No. 1882, 70th Cong., 1st Sess., pp. 16–17.

they remained in existence and undissolved, at least until December 30, 1929, upon which date the stockholders of the two companies authorized the filing of certificates of suspension of business with the State Corporation Commission of New Mexico. (R. 53–54.) On the latter date the petitioner still owned its stock in the subsidiaries. (R. 53.)[3] Consequently, affiliation continued, at least until December 30, 1929. This Court has expressly held that corporations have not ceased to be affiliated, "merely because, without change of corporate control, one of them was being liquidated." *Burnet* v. *Aluminum Goods Manufacturing Co., supra,* p. 548.

It appears from the terms of Article 37 (a) that it applies to every case in which at the time of distribution the requisite percentage of stock is held by the parent corporation. Any other construction would deprive of effect that portion of the article which provides that gain or loss shall not be recognized upon a distribution in redemption or cancellation of *all* of the stock. To hold that distribution in this case was not during a consolidated return period would overlook any distinction between Article 37 (a) and Article 37 (b) (*infra,* p. 36). The former refers to dissolutions which for all practical purposes are concurrent with cessation of affiliation caused by the dissolution and the events

[3] Findings as to these undisputed facts were requested from the District Court and refused. (R. 15–16.) An exception was taken to this refusal (R. 17), and it was assigned as error. (R. 106.) See note 1, p. 4, *supra.*

leading up thereto, while the latter provision refers to those dissolutions or distributions occurring after the affiliated group is no longer filing consolidated returns or after the subsidiary has ceased to be a member of the group although the former parent continues to own some part of the stock.

The Circuit Court of Appeals did not decide whether the distributions occurred during a consolidated return period within the meaning of Articles 37 (a) and 40 (a) of the Regulations, but held that even if within the period, the losses must nevertheless be recognized.[4] While that court decided this

[4] The court's treatment of this point in its opinion on rehearing (R. 127–129) seems to be based solely upon an article by the Secretary of the Treasury which the court believed evidenced the fact that the Treasury Department construed the Regulations as permitting apparent deductions realized on the winding up of a subsidiary. We submit that, on the contrary, this article shows that the Regulations intended to eliminate all liquidating gains or losses where the liquidation occurred at the time affiliation was in effect. The material portion of the article referred to is printed in Appendix B, *infra*, pp. 38–39. It shows that due to the impossibility as a practical matter of prescribing rules which would distinguish those types of dissolution upon which gain or loss should be recognized from those in which gain or loss should not be recognized, it was concluded, in the interest of certainty as to the rule to be applied, to treat all dissolutions as intercompany transactions. The article in question, written by the Secretary of the Treasury who approved the Regulations, merely serves to affirm the clear intent embodied therein to recognize neither gain nor loss upon liquidation of a subsidiary.

particular point against the respondent, it is open for consideration here in support of the judgment below. *Langnes* v. *Green*, 282 U.S. 531, 535–538; *Story Parchment Co.* v. *Paterson Co.*, 282 U.S. 555, 560. We submit that the plain terms of Articles 37 (a) and 40 (a) of the Regulations show that they are applicable, and that the court below was in error in holding that under them the losses in question may be recognized.

In providing that gain or loss upon liquidation of a subsidiary shall not be recognized, Articles 37 (a) and 40 (a) of the Regulations are reasonably adapted to carry out the purpose of clearly reflecting income and preventing the avoidance of tax liability. Insofar as advances are concerned, this effect is plain. Advances in their very nature are intercompany transactions representing the lending of money by one branch of the business to another for operating purposes. In such case the loss to the group as a whole has not occurred when the obligation to repay the amount became worthless but at some prior time when the money borrowed was lost in operations. Such a loss has usually been reflected by way of deduction either against the income of a successful member of the group or against that of the borrower by carrying it forward under the authority of the net loss provisions of the statutes. To allow the loss on liquidation will frequently result in a duplication of deduction.

An example will show the extent to which such an allowance might possibly be taken. Corporations A, B, C and D are affiliated. In 1928 A loans $4,000 to B, B loans the same $4,000 to C, and C loans the same money to D to cover a current operating loss. The affiliated group takes a deduction for D's operating loss in 1928. In 1929 D becomes insolvent and C charges off the debt as worthless. In 1930 C becomes insolvent and B charges off the debt as worthless. In 1931 B becomes insolvent and A gets a deduction for a bad debt. Under such circumstances A, having income in excess of its subsidiaries' losses for each of the years, would have benefited four times on account of the one ultimate loss.

Similarly, the investment in the subsidiary by the purchase of its stock may frequently be the subject of duplicate deductions if the deduction is allowed when the subsidiary is liquidated. As a result of purchasing the stock the parent acquires the subsidiary and its assets and operates the subsidiary as a branch. The cost of these assets, gradually dissipated through operations, will have been represented by deductions taken by the affiliated group in prior years. To allow their deduction again as capital losses or worthless debts would be to distort the income and to permit, rather than to prevent, the avoidance of tax liability.

In the *Aluminum Goods* case this Court stated that no method of calculating income upon a consolidated return can be upheld (for 1928 and prior

years) which would deny all deductions for losses and at the same time would not further the purpose of preventing a distortion of the income of the unitary business. In that case it was apparent that prior years' losses of the subsidiaries had never been allowed as deductions. Here, as we contend under Point II (*infra*, pp. 18–27), such deductions had been allowed and a distortion would result from a second allowance. Accordingly, this is not a case in which the Regulations impose a burden upon the taxpayer. But even in cases where a burden results in the sense that a loss otherwise allowable is not granted, it is only because the affiliated group has taken advantage of the privilege of filing a consolidated return. This privilege confers material benefits not granted upon the filing of separate returns, in particular, the right to offset against the income of one member of the group the losses of another. Having availed itself of the privilege granted, the group should not be allowed to complain of the conditions annexed to the grant. *Grand Rapids & Indiana Ry. Co. v. Osborn*, 193 U.S. 17, 29.

II

NO DEDUCTIONS CAN BE ALLOWED IN ANY EVENT SINCE THE PETITIONER, THROUGH THE MEDIUM OF CONSOLIDATED RETURNS IN PRIOR YEARS, RECEIVED DEDUCTIONS FOR LOSSES OF ITS SUBSIDIARIES EXCEEDING IN AMOUNT THOSE NOW CLAIMED

The petitioner contends that Articles 37 (b), 40 (c), and 34 (c) (2) of Regulations 75 (*infra*,

pp. 36, 37, 33), are applicable to this case; that under the provisions of Article 34 (c) (2), the Commissioner has provided that only losses of a subsidiary for 1929 and subsequent years should be offset against the parent's loss and that prior years' losses should be disregarded. Article 34 (c) (2) is by its terms applicable only in the case of *sale* of the stock or in the situations embraced within Articles 37 (b) or 40 (c). It does not apply and was not intended to apply to distributions occurring during a consolidated return period.

As we have contended under Point I, *supra*, the distributions here occurred during a consolidated return period and are governed by the provisions of Articles 37 (a) and 40 (a) of the Regulations (*infra*, p. 36). These two articles contain no reference to Article 34 (c) (2) and the latter article has no application to the facts in this case. The court below did not hold that Articles 37 (b) and 34 (c) (2) applied, but stated (R. 126–127) that even if it be assumed that they governed the case the petitioner had failed to show that the Commissioner's determination was erroneous.

Even if our previous contention is wrong, and Article 34 (c) (2) should be held to apply, the fact that it prescribes that there should be deducted from the basis of the stock, the aggregate of the subsidiary's losses "sustained during each of the consolidated return periods (including only the taxable year 1929 and subsequent taxable years) after such corporation became a member of the

group" does not demonstrate that losses prior to 1929 should not also be deducted from the basis. Article 34 (c) (2) is only a part of the whole scheme for determining losses in such a case.

Article 34 (c) in its entirety furnishes the rules for the computation of gain or loss in cases of sales of stock which break affiliation and, by reference, in cases coming within the provisions of Articles 37 (b) and 40 (c). Subdivision (1) of Article 34 (c) provides that the basis must first be adjusted under Sections 111 to 115, inclusive, of the Revenue Act of 1928, before making the adjustments prescribed in subdivision (2) of Article 34 (c). When Article 34 is examined as a whole, it is plain that Article 34 (c) (2) does not come into operation until after Article 34 (c) (1) has been applied.

The Regulations were drafted in this manner in order to avoid discrimination. Some affiliated groups which had filed consolidated returns prior to 1929 might not be willing to subscribe to the new Regulations and would not consent to be governed by them. If the parent of such a group filed a separate return and sold a subsidiary's stock in 1929, Regulations 75 would not apply and the adjustment of its basis for gain or loss on account of prior years' losses would be in accordance with Sections 111 to 115 of the Revenue Act of 1928 and the final interpretation of these provisions by the courts. The Commissioner did not demand that an affiliated group desiring to file a consolidated return for 1929 must subscribe to a specific regulation whereby it

would waive all right to litigate this controversial question with respect to events of years prior to 1929.

If the Commissioner in Article 34 had specifically required adjustments for losses prior to 1929, discrimination would have resulted against affiliated taxpayers accepting his regulations, in the event that it was ultimately determined by the courts that under the general provisions of the Revenue Acts such prior years' losses need not be applied to reduce losses upon the sale. No attempt was made, therefore, to cover the question in Regulations 75. Those regulations settled the question only insofar as operating losses in 1929 and subsequent years were involved and left the question with respect to losses for 1928 and prior years open for determination in accordance with what the courts might decide. Both paragraphs of Article 34 (c) must be considered together if either is to be considered at all.

We have contended before that Article 34 does not apply at all; but, if it is applicable so that the provisions of Article 34 (c) (1) become material, the court below properly held that the petitioner was not entitled to recover, since it had received deductions against its income in previous years for losses of the subsidiaries exceeding in amount the losses now claimed. As the court below stated (R. 118–119), to say that the petitioner sustained a

loss of $306,430.49 on a total investment of $168,812.49 (in both subsidiaries) "is to say what cannot be"—a manifest impossibility.

The statute allows generally the deduction of losses sustained during the taxable year and not compensated for by insurance or otherwise. Section 23 (f) of the Revenue Act of 1928. But the statute never contemplated that the losses should be deducted twice, and unless a double deduction is plainly required it should not be allowed. This Court stated the rule in the *Aluminum Goods* case, 287 U.S. 544, 551, *supra*, where it said that—

> equitable principles of accounting applied to the calculation of the net income of the business unit do not permit deduction of the loss twice * * *.

See also *United States* v. *Ludey*, 274 U.S. 295, 301. Similar double deductions by affiliated corporations have been denied in several cases. *Swift & Co.* v. *United States*, 69 C.Cls. 171; *Levi Strauss Realty Co.* v. *Commissioner*, 41 F. (2d) 55 (C.C.A. 9th); *Kaiwiki Sugar Co.* v. *Bugbee*, 63 F. (2d) 822 (App.D.C.).

The consolidated returns provisions view the business as a unit, in practical effect a single enterprise conducting the business through several different branches. "The purpose of the Congress was to secure substantial equality among stockholders who ultimately bear the burden of taxation and to prevent evasion through the manipulation of intercompany transactions." *Atlantic City Electric Co.*

v. *Commissioner*, 288 U.S. 152, 154. If the petitioner had in fact conducted its business through unincorporated branches, the double deduction here claimed would be impossible.

The fact that the purchase of the stock by the parent represented a capital investment, while the losses of the subsidiaries in years prior to liquidation were operating losses, cannot serve to permit the parent to recover more than its actual investment. The operating losses of prior years were not the petitioner's but were those of the Springer Company and the Roy Company. As they occurred they served to impair the capital value of the subsidiaries equally with the amount of the advances made by the petitioner for use in the subsidiaries' operations. These losses were reflected in the diminishing value of the petitioner's stock investment in the subsidiaries and the obligations represented by the advances. Mere nomenclature, as the court below observed (R. 127), cannot suffice to give a double allowance.[3]

Our contention in this respect is supported by the weight of authority. In addition to the deci-

[3] We cannot assent to the petitioner's statement (Br. 19, 33) that if the three affiliated corporations had filed separate returns for 1929, the parent corporation would have been entitled to deduct the full amount of the loss claimed here. The rule stated in the *Aluminum Goods* case is applicable, we submit, whether the liquidation of the subsidiary occurs during a consolidated or a separate return period. The significant fact is that the parent has once benefited by the subsidiary's losses; it cannot thereafter on any return claim another deduction for what is in reality the same loss.

sion below, the Circuit Court of Appeals for the Fourth Circuit has held in two decisions that a loss suffered upon liquidation must be offset by prior years' losses of the subsidiary, deducted by the parent on consolidated returns. *Burnet* v. *Riggs Nat. Bank*, 57 F. (2d) 980; *Commissioner* v. *Apartment Corp.*, 67 F. (2d) 3. The same result has been reached by the Board of Tax Appeals. *Summerfield Co.* v. *Commissioner*, 29 B.T.A. 77; *National Casket Co.* v. *Commissioner*, 29 B.T.A. 139. While there was no actual deduction of prior years' losses in the *Aluminum Goods* case, the subsidiary's loss for 1917 was offset for excess profits tax purposes against the loss allowed on liquidation, and this Court indicated, as we have shown above, that proper accounting principles "do not permit deduction of the loss twice."*

The only decision directly in conflict is that of *United Publishers' Corporation* v. *Anderson*, 42 F.

* The Commissioner originally took the position that upon the sale of the subsidiary's stock the amount of the gain or loss should be adjusted by the amount of the subsidiary's losses used as an offset against the income of the parent in prior years' consolidated returns. G.C.M. 7765, IX–1 Cumulative Bulletin 223. Following the decision in *United Publishers' Corporation* v. *Anderson*, 42 F. (2d) 781 (S.D. N.Y.), *infra*, the former rule was modified to eliminate from consideration prior years' losses. G.C.M. 8889, IX–2 Cumulative Bulletin 236. After the decision in the *Aluminum Goods* case the ruling contained in G.C.M. 7765 was reinstated and that in G.C.M. 8889 was revoked. G.C.M. 11676, XII–1 Cumulative Bulletin 75. This represents the present administrative policy with respect to the determination of gain or loss upon the sale of a subsidiary's stock.

(2d) 781 (S.D.N.Y.). That court, erroneously we contend, held that the situation was the exact converse of that obtaining in *Remington Rand, Inc.* v. *Commissioner,* 33 F. (2d) 77 (C.C.A. 2d), certiorari denied, 280 U.S. 591. In the latter case it was held that where a parent corporation sold its stockholdings in a subsidiary the excess of the selling price over the cost of the stock was taxable as a gain and that the gain was not to be reduced by undistributed accumulated earnings of the subsidiary taxed in previous years. It cannot be said, however, that the cases of gains on the one hand and of losses on the other must necessarily be treated alike. The one is not the converse of the other. In the case of losses, affiliation brings to the group a benefit it otherwise would not have had—the right to offset the losses of one member against another's gains. But there is no corresponding detriment to the group in the case of gains. Under the Act in question, the group pays no more tax when all have gains than it would have paid if separate returns had been filed.

The taxation of the gain when earned by the subsidiary and again when it is realized by the parent, as the court below recognized (R. 118), is simply the usual case of a tax being paid by a corporation on its earnings and by its stockholder on his gains realized on a disposition of his holdings. Moreover, the decision in the *Remington Rand* case presents no obstacle or hardship to the parent corporation which is not solely within its

control. The seeming double tax may apparently be avoided by the parent causing the subsidiary to declare in dividends the amount of its earnings which represents a gain to the parent on its investment in the subsidiary. Such dividends would not be taxable to the parent, because they are intercompany transactions and also because dividends received by a corporation are not taxable. After the declaration of the requisite dividend the subsidiary's remaining assets may then be transferred to the parent in liquidation of its investment and without any taxable gain. It is apparent, therefore, that the *Remington Rand* decision furnishes no basis for the allowance of a double deduction for the same loss.

In *Burnet* v. *Imperial Elevator Co.*, 66 F. (2d) 643 (C.C.A. 8th), cited by the petitioner (Br. 29), the present question was not squarely considered. The court there stated that operating losses of the subsidiary are different from losses on its stock. But the court's decision did not involve the subsidiary's operating loss. It turned on the fact that the parent's loss on the liquidation of the subsidiary was so large that it offset the parent's operating income for that year, and for the second following year as well, without any resort to the operating loss of the subsidiary. There was, therefore, no double deduction. Losses of prior years were not referred to or considered. In *McLaughlin* v. *Pacific Lumber Co.*, 66 F. (2d) 895 (C.C.A. 9th), the court did not specifically hold that prior

years' losses taken as deductions by the parent should not be offset against a loss on liquidation, but stated that the collector had failed to establish any specific instance of a double deduction.

CONCLUSION

While we contend that the court below was in error in holding that the loss on liquidation must be recognized, it correctly decided that recognizable losses of the parent must be offset by prior years' deductions and therefore it reached the correct result. Its decision should be affirmed.

Respectfully submitted.

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FEBRUARY, 1934.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * *

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. * * *

* * * * * *

(U.S.C.Sup. V, Title 26, Sec. 2115.)

SEC. 141. CONSOLIDATED RETURNS OF CORPORATIONS—1929 AND SUBSEQUENT TAXABLE YEARS.

(a) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of

such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(c) *Computation and payment of tax.*—In any case in which a consolidated return is made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the date on which such return is made. Only one specific credit, computed as provided in section 26 (b), shall be allowed in computing the tax.

(d) *Definition of "affiliated group".*—As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per

centum of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

* * * * * *

(U.S.C.Sup. V, Title 26, Sec. 2141.)

Treasury Regulations 75, promulgated under the Revenue Act of 1928 and applicable to 1929 and subsequent years:

ART. 2.—DEFINITIONS.

* * * * *

(e) *Consolidated Return Period.*—The term "consolidated return period" means the taxable year 1929, or any subsequent taxable year, for which a consolidated return is made or is required.

* * * * * *

ART. 11.—CONSOLIDATED RETURNS FOR SUBSEQUENT YEARS.

* * * * * *

(c) *When Affiliated Group Remains in Existence.*—For the purposes of these regulations, an affiliated group shall be considered as remaining in existence if the parent corporation remains as a parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have become subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

(d) *When Affiliated Group Terminates.*—For the purposes of these regulations, an affiliated group shall be considered as terminated if the parent corporation ceases to be the parent or if there is no subsidiary affiliated with it.

ART. 13.—CHANGE IN AFFILIATED GROUP DURING TAXABLE YEAR.

(This article has no bearing upon the question as to whether a consolidated return may or must be filed, but relates only to the effect of changes in the affiliated group during the taxable year.)

(a) *General Rule.*—Except as hereinafter provided, a consolidated return must include the income of the parent and of each subsidiary for the entire taxable year.

* * * * *

(c) *Complete Termination of Affiliated Group prior to Close of Taxable Year.*—If an affiliated group is terminated prior to the close of the taxable year of the group, the consolidated return must include the income of the parent for its entire taxable year (excluding any portion of such year during which its income is included in the consolidated return of another affiliated group) and of each subsidiary for the period prior to the termination. (See paragraphs (c) and (d) of article 11, in determining whether the group has terminated.)

* * * * *

(e) *Elimination from Group of a Subsidiary during Year.*—If a subsidiary ceases to be a member of the affiliated group during the taxable year of the group, the consolidated return must include its income for the period during which it was a member of the group.

* * * * *

ART. 31.—CONSOLIDATED NET INCOME.

(a) *Definition.*—Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the

aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as "intercompany transactions").

ART. 34. SALE OF STOCK—BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Scope of Article.*—This article prescribes the basis for determining the gain or loss upon any sale or other disposition (hereinafter referred to as "sale") by a corporation which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for the taxable year 1929 or any subsequent taxable year, of any share of stock issued by another member of such group (whether issued before or during the period that it was a member of the group and whether issued before, during, or after the taxable year 1929), and held by the selling corporation during any part of a consolidated return period. (For the basis in the case of sales of bonds, see article 35.) The paragraphs of this article are applicable to sales during different periods of time, as follows:

(1) Sales which do not break the affiliation—paragraph (b);

(2) Sales which break the affiliation and which are made during the period that the selling corporation is a member of the affiliated group (whether or not during a consolidated return period)—paragraph (c);

(3) Sales made after the selling corporation has ceased to be a member of the affiliated group—paragraph (d).

(b) *Sales which do not Break Affiliation.*—If notwithstanding any such sale the

issuing corporation remains a member of the affiliated group, such basis shall be determined and adjusted in the same manner as if the selling corporation and the issuing corporation had never been members of an affiliated group. (See sections 111 to 115, inclusive, of the Act, and articles 561 to 629, inclusive, of Regulations 74.)

(c) *Sales which break Affiliation made while Selling Corporation is Member of Group.*—If the sale is made during a period during which the selling corporation is a member of the affiliated group (whether or not during a consolidated return period), and if, as a result of such sale, the issuing corporation ceases to be a member of the affiliated group, such basis shall be determined as follows:

(1) The aggregate basis of all shares of stock of the issuing corporation held by each member of the group (exclusive of the issuing corporation) immediately prior to the sale, shall be determined separately for each member of the group, and adjusted in accordance with the Act (see sections 111 to 115, inclusive, of the Act, and articles 561 to 629, inclusive, of Regulations 74);

(2) From the sum of the aggregate bases, as determined in paragraph (1) above, there shall be deducted the aggregate of the losses of such issuing corporation sustained during each of the consolidated return periods (including only the taxable year 1929 and subsequent taxable years) after such corporation became a member of the group and prior to the sale of the stock, to the extent that such losses could not have been availed of by such corporation as a net loss in computing its tax for such periods if it had made a separate return for each of such periods;

(3) The total aggregate basis of all shares of stock, after making the deduction under paragraph (2), shall then be allocated to each member of the group which holds stock in the issuing corporation, in the ratio that the basis of each, as determined under paragraph (1), is to the sum of the bases of all;

(4) The aggregate basis as determined under paragraph (3) for each member of the group shall then be equitably apportioned among the various classes of stock held by such member according to the circumstances of the case—ordinarily in the ratio that the basis of each class of stock held by it at the time of the sale is to the sum of the bases of each class of stock held by it;

(5) The basis of each share of stock of each class held by a member of the group shall then be determined by dividing the basis apportioned to such class under paragraph (4) by the total number of shares of such class held by it.

* * * * *

(d) *Sales after Selling Corporation has ceased to be a Member of the Group.*—If the sale is made after the selling corporation has ceased to be a member of the affiliated group, such basis shall be determined in accordance with paragraph (c) of this article, except that—

(1) The aggregate basis (under subparagraph (1) of such paragraph) shall be determined for all shares of the issuing corporation held by each member of the group immediately prior to the time the selling corporation ceased to be a member of the group (rather than immediately prior to the sale); and

(2) The allocations (under subparagraph (3) of such article) shall be made to each

member of the group which held stock of the issuing corporation immediately prior to the time the selling corporation ceased to be a member of the group (rather than to the members holding such stock at the time of the sale); and

(3) The basis of each share of stock held by the selling corporation (determined, as above, as of the time the selling corporation ceased to be a member of the group) shall then be adjusted in accordance with the Act (see, particularly, sections 111 to 115, inclusive, of the Act and articles 561 to 629, inclusive, of Regulations 74) in order to determine the basis at the time of the sale.

(e) *Limitation on Adjustment For Losses.*—No deduction shall be made under paragraph (c) (2) of this article, in the event of a consolidated net loss which was sustained more than two years prior to the close of the taxable year during which the sale was made and which was not availed of by the members of the affiliated group in computing the tax for the consolidated return period, for that portion of such net loss which the losses of the subsidiary for the year in which such net loss was sustained bears to the aggregate losses of each of the members of the group.

* * * * *

ART. 35.—SALE OF BONDS—BASIS FOR DETERMINING GAIN OR LOSS.

In the case of a sale or other disposition by a corporation, which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for the taxable year 1929 or any subsequent taxable year, of bonds issued by another member of such group (whether or not issued while it was a member of the group and whether

issued before, during, or after the taxable year 1929), the basis of each bond, for determining the gain or loss upon such sale or other disposition, shall be determined in accordance with the Act (see, particularly, section 113 of the Act), but the amount of any loss otherwise allowable shall be decreased by the excess (if any) of the aggregate of the deductions computed under paragraph (c) (2) of article 34 over the aggregate of the basis of the stock of the issuing corporation as computed under paragraph (c) (1) or (d), as the case may be, held by the members of the affiliated group. (See, also, article 40 (e), relating to disallowance of loss upon intercompany bad debts.)

ART. 37.—DISSOLUTIONS—RECOGNITION OF GAIN OR LOSS.

(a) *During Consolidated Return Period.*—Gain or loss shall not be recognized upon a distribution during a consolidated return period, by a member of an affiliated group to another member of such group, in cancellation or redemption of all or any portion of its stock; and any such distribution shall be considered an intercompany transaction.

(b) *After Consolidated Return Period.*—Any such distribution after a consolidated return period, whether in complete or partial liquidation, shall be treated as a sale of the stock, and the adjustments specified in articles 34 and 35 will be made, and article 36 will be applicable.

ART. 40.—BAD DEBTS.

(a) *Resulting From Transactions During Consolidated Return Period.*—Intercompany accounts receivable or other obligations which are the result of intercompany transactions during a consolidated return

period shall not be deducted as bad debts during a consolidated return period.

* * * * *

(c) *Limitation on Allowance after Consolidated Return Period.*—The rules applicable to the allowance of losses upon the sale of bonds shall be applicable to the allowance after the consolidated return period as a bad debt of an intercompany account receivable or other obligation resulting from an intercompany transaction during the consolidated return period. (See article 35.)

APPENDIX B

Extract from an article by A. W. Mellon, Secretary of the Treasury, printed in the National Income Tax Magazine for March, 1929, Vol. VII, No. 3, p. 106:

> *Dissolution of Subsidiary.*—Neither gain nor loss is recognized upon the dissolution of a subsidiary. Dissolutions may, in theory, be classified into three general types: (a) A "purchasing" dissolution, where, in order to obtain the assets, the stock is purchased and the corporation then dissolved; (b) a "reorganization" dissolution, where a subsidiary is dissolved in order to effect a purely internal rearrangement or reorganization; and (c) a "winding-up" dissolution, where it is decided to abandon the business and close out the affairs of the subsidiary. Obviously, no gain or loss should be recognized, for none is actually realized, in the case of dissolutions of the first two types, while any gain should be taxed and any loss allowed as a deduction in the case of a dissolution of the third type. Generally speaking, however, dissolutions as a practical matter cannot be readily classified. Transactions falling into more than one of the three types are very frequently involved, and the purposes of a dissolution do not always remain constant and are not always apparent or ascertainable. Inasmuch as it would be impossible to prescribe a rule which would distinguish the types and which would

be susceptible of sound administration, and in view of the fact that the benefit of losses which are properly allowable are not denied if the loss is realized before the dissolution or if the subsidiary is not a member of the group at the time of the dissolution, it was concluded that the rule adopted in the Regulations, treating all dissolutions as intercompany transactions, was the safest and best and would prove the most satisfactory. Very substantial benefits both to taxpayers and the Government will result in the certainty as to the rule which is to be applied.

U. S. GOVERNMENT PRINTING OFFICE: 1954

IN THE

Supreme Court of the United States.

OCTOBER TERM 1933.

No. 579.

CHARLES ILFELD COMPANY, *Petitioner,*

v.

B. C. HERNANDEZ, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF NEW MEXICO.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

May it please the Court:

The undersigned, Theodore B. Benson, as counsel for The Apartment Corporation, respectfully moves the Court for leave to file the accompanying brief, as amicus curiae, and in support of this motion, shows unto the Court as follows:

The petition of The Apartment Corporation for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is pending before this Court, October 1933 Term, Number 690, and the question there involved, although not precisely the same, is similar to the question presented in the instant case. In Number 690, the respondent has suggested to this Court that decision on the application for certiorari be deferred until argument and decision in the instant case, and petitioner is anxious to have before the Court in the instant case a full discussion of the issues presented.

The purpose of this brief is to present to this Court the view that the Court of Appeals in each of the cases in question erroneously assumed that the taxpayer was claiming the right to a double deduction of the same loss, and refused to follow plain statutory provisions for computing losses.

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Of Counsel.

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AMICUS CURIAE BRIEF ON BEHALF OF THE APARTMENT CORPORATION.

STATEMENT.

In the petition for the writ filed by the Apartment Corporation, No. 690, the facts are stated beginning at page 2, and the applicable provisions of the Revenue Act of 1926 are set forth beginning at page 4 and are not repeated here.

SUMMARY OF ARGUMENT.

The loss incurred when a parent corporation liquidates a subsidiary is an actual loss on the disposal of the stock of the subsidiary and on the taking over of its assets and this loss is not offset or reduced by prior operating losses. The right of the parent to claim the loss is expressly conferred by Sections 202, 203 and 204 of the Revenue Act of 1926 and the corresponding sections 111, 112 and 113 of the Revenue Act of 1928. The basis for determining the amount of the loss is in no manner to be adjusted with reference to operating losses of the subsidiary during prior years.

THE ARGUMENT.

I.

The loss on investment is a real loss, not reduced by operating losses of prior years.

The *Charles Ilfeld Company* case involves the construction of the provisions of Section 142 of the Revenue Act of 1928 which differ from those of the Revenue Act of 1926 and also has to do with Regulations 75 which have no application to the year 1926. The arguments herein are confined to the applicable sections of the Revenue Act of 1926. These sections are those that relate to the method of computing the income of an affiliated group of corporations and those that relate to the determination of a loss on the sale or disposal of property.

The position of the Apartment Corporation is that Congress has in Section 240 of the Revenue Acts of 1921, 1924 and 1926 provided for the filing of affiliated returns and that in Sections 202, 203 and 204 it has provided that on the sale of property the entire amount of the loss shall be recognized, and that these several provisions are separate and distinct. The one has to do with the determination of the income of the affiliated group for each particular year and the other has to do with the loss sustained on the sale of the stock of the subsidiary.

In his brief in the *Charles Ilfeld Company* case the respondent takes the position that no double allowance can be made for the operating losses in the prior years and for the loss on the disposition of the stock of the subsidiary in a later year. The position of the Apartment Corporation is that we are not necessarily concerned with the determination of a double allowance but in the application of the several specific statutory provisions to the several years involved.

The reasoning of the respondent in *Charles Ilfeld Company* case is that as the operating losses of a subsidiary take place they serve to impair the capital value of the subsidiary. This may or may not be true for operating losses are dependent on business conditions during the year of operation and the amount realized by the parent corporation from its investment in the subsidiary is dependent on the remaining assets and the

market conditions during the year of the sale or disposal of the stock of the subsidiary. The mere fact that the subsidiary operated at a loss in some prior year may have no bearing whatever on the amount of loss sustained by the parent corporation in the future year when the stock of the subsidiary is disposed of. In considering the soundness of the reasoning of the respondent the thought must not be lost sight of that no loss can be claimed by the parent corporation on account of its investment in the subsidiary until it disposes of the latter's stock by sale or exchange. *U. S. v. White Dental Mfg. Company*, 274 U. S. 398.

It is submitted that Section 240 and its objects have no bearing upon the subject covered by Sections 202, 203 and 204 of the Revenue Act of 1926. By Section 240, Congress provided a method of determining the annual operating income of an affiliated group of corporations, and by the provisions of Sections 202, 203 and 204 it provided that the entire amount of the loss realized by a parent corporation on the disposal of the stock of the subsidiary should be deducted in the year of sale or disposal.

If this position is not upheld it will mean that at least two of the clearly expressed intents of Congress will be defeated. These are that income shall be determined on an annual basis and that taxable income of affiliated corporations filing a consolidated return shall be the income of the group.

For the year 1921 the Apartment Corporation, the University Homes Company and the Consolidated Apartment House Company were required to file a consolidated return and to report therein the loss sustained by the University Homes Company in the amount of $50,764.31. The provisions of the Revenue Act of 1921 with reference thereto are absolute and the Apartment Corporation was required to join in such return and to claim such losses whether or not to its benefit or to the benefit of the third corporation. In subsequent years the filing of a consolidated return was optional. The option was not exercised for the years 1922 and 1923, if the decision of the Board of Tax Appeals in *Apartment Corporation* v. *Commissioner*, 17 B. T. A. 876, is correct.

In his brief in the *Charles Ilfeld Company* case the respondent states that the parent Corporation can not recover more than its actual investment. The Circuit Court of Appeals for the Fourth Circuit followed this line of reasoning and based its conclusion on the assumption that the Apartment Corporation sustained no deductible loss in 1926 because the losses allowed the affiliated group in previous years were in excess of the loss sustained by reason of the advances. The holding of that court is that the losses were allowed to the Apartment Corporation. This it is submitted is erroneous for the reason that the Apartment Corporation during the prior years was merely a member of an affiliated group and the operating losses were not allowed as deductions to the Apartment Corporation but were merely taken into account in determining the income of the group and there is no reason to suppose that the Consolidated Apartment House Corporation was not benefited equally with the Apartment Corporation. As a matter of fact the Circuit Court of Appeals for the Fourth Circuit ignored entirely the fact that consolidated returns for prior years were filed under the provisions of Section 240 of the several revenue acts and apparently finds that the Apartment Corporation has claimed deductions annually because of its advances to the University Homes Company. The reasoning adopted by that court is not based on the provisions of the several revenue acts and because of that is erroneous.

The respondent in his brief in the *Charles Ilfeld Company* case, following in the steps of the Circuit Court of Appeals for the Fourth Circuit, states that the subsidiary corporation is to be considered as a branch of the parent. This conclusion is directly in conflict with the provisions of Section 240 with reference to affiliated returns. In an affiliated return a subsidiary corporation is not treated as a branch but as a corporation of equal dignity with the parent corporation. The relationship is looked to merely to determine the fact of affiliation and not to determine the income of the group. Once in the group the distinction between the corporation as parent and subsidiary ceases.

The contention of the respondent that the *Charles Ilfeld*

Company is seeking to claim a double deduction is a mere conclusion based on an assumption that the allowance of the operating loss to the affiliated group and the allowance to the parent corporation of the loss sustained on the disposal of the stock of the subsidiary amounts to a double deduction to the parent corporation. Just what this benefit would be would, of course, require proof of the actual benefit to the parent corporation during prior years which would involve two things that Congress has clearly sought to avoid. The first is, as above stated, the determination of income on an annual basis and the second is the avoidance of complicated and difficult adjustments in tax determination.

Just what the benefit to the parent corporation would be would involve considerable proof of what had transpired in prior years and would bring into consideration the several rates of taxation which Congress has seen fit to change for the several years. This is clearly demonstrated by the record in the *Ilfeld* case. We take as an example the case of the Ilfeld Company and its subsidiary the Springer Trading Company. The operating losses of the Springer Company for some of these years, being combined with income earned by the other members of the group for the purpose of tax computation, naturally reduced the tax liability of the group. The amount of such reduction in tax liability does not appear in the record, but the amount of the Springer Company's losses does appear. As the tax on corporate income since 1921 has been at a flat rate, it is easy to compute the actual reduction of tax liability for the years 1922 to 1928, inclusive, growing out of the situation. An examination of the footnote[1] will show that

Year	Springer Co. loss	Tax Rate	Tax Reduction
1922	$30,701.29	12½	$3,837.66
1923	3,794.38	12½	474.29
1924	4,719.71	12½	589.96
1925	11,100.64	13	1,443.08
1926	3,552.31	13½	479.56
1927	4,491.22	13½	606.31
1928	2,572.83	12	308.74
Totals	$60,932.38		$7,739.60

the advantage derived by the group from the filing of a consolidated return with the Springer Company for those years, in dollars and cents, amounted to $7,739.60, and not $60,932.38 as decided by the court below. This is without consideration of the fact that the benefit in question was more than offset by the amount of the operating losses. In other words, the affiliated group, and ultimately the parent corporation, is actually poorer as a result of the operating losses there set out, even after getting the benefit of the tax reduction under a consolidated return, by $53,192.78. Yet the respondent treats the case as though the parent had actually received a return of its investment of $60,932.38, simply because the subsidiary had operating losses of that amount! With this graphic statement of the elements involved, it becomes obvious that the respondent, under the guise of an argument that petitioner is claiming a double deduction of the same loss, is refusing in fact to offset investment in the stock of the subsidiary against the proceeds on liquidation of the investment. His argument resolves itself into the proposition that a taxpayer which has been penalized by unprofitable operation shall be further penalized by being denied the right to deduct the full and actual loss on investment.

II.

The right to deduct the loss on investment, without regard to operating losses of prior years, is expressly conferred by statute.

The mere fact that a taxpayer may receive a benefit or even a double benefit from an express provision of the revenue act should not defeat his right to claim what Congress has expressly conferred on him, which in the case of the Apartment Corporation is the entire amount of the loss sustained and which is defined as the excess of the cost over the amount realized without any mention of, or provision for, adjustment for operating losses in prior years.

Section 203 (a) *requires* that the "entire amount" of the loss (which section 234 permits as a deduction) "determined

under section 202" be recognized. Section 202 provides that the loss shall be the excess of the basis provided in 204 over the amount realized on disposition of the stock. Section 204 says that such basis shall be "the cost" of the stock, but provides for adjustment of that basis under various circumstances not applicable to our situation. It is to be assumed that Congress did not have in mind, but left to implication, any other provision for a reduction of the basis. *Expressio unius est exclusio alterius.* Furthermore if these statutory provisions needed clarification, in determining their application to a situation like ours, Section 201 (c) should set at rest all shadow of doubt. That section provides that "amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock * * *. The gain or loss to the distributee * * * shall be determined under Section 204 * * *."

A taxpayer should not be permitted to circumvent or defeat the provision of the revenue act, but certainly there is nothing unjust or inequitable in his accepting a benefit expressly conferred by a provision of the act.

There are many inequitable provisions in the several revenue acts and there is much double taxation. A clear illustration of this is the imposition of the capital stock tax on a parent corporation by the inclusion of the value of the assets of a subsidiary which is also required to pay the tax on the same assets. In the present case the Apartment Corporation was required to pay the capital stock tax on the value of the stock of the University Homes Company which in turn was required to pay the same tax on the value of the same assets. This is double taxation and the corporations could not escape the inequitable provisions of the law for the simple reason that Congress had by express provision levied the same tax on the value of the same assets to each corporation.

It is submitted that the same line of reasoning which upholds the principle of double taxation should apply to deductions and that it is within the power of Congress by express legislation to allow the same or similar deductions in different years.

In the case of *Remington Rand* v. *Commissioner*, 33 Fed.

(2d) 77, certiorari denied 280 U. S. 591, the situation was the exact converse and it was held that on the sale by the corporation of the stock of the subsidiary the excess of the selling price over the cost of the stock is taxable as a gain and that this taxable gain is not to be reduced by the amount of undistributed accumulated earnings of the subsidiary which had been taxed in previous years in affiliated returns. This is a clear illustration of double taxation which Congress has expressly provided shall be levied and it is submitted that the same principle should be applied in determining the amount of a loss that was there applied in determining the amount of a gain. The provisions of the revenue act with reference to the determination of gain and loss are contained in the same sections and are identical. To do as the respondent suggests is to apply different rules of construction to the same statute to meet different situations. To define gain in the one sense and loss in the other would, of course, defeat the clearly stated intent of Congress which is that the entire amount of either the gain or the loss shall be recognized regardless of what might have transpired in some prior years.

The respondent's argument presupposes that the subsidiary's loss was applied solely in reduction of the parent's income, whereas it actually reduces ratably the income of other subsidiaries having income. If the Government's theory be adopted, however, the parent will be charged with all such operating losses as a theoretical return of capital. Furthermore, it will be charged with such losses even where the subsidiary's income in other years equals or exceeds its losses, because, under the decision in *Remington Rand* v. *Commissioner*, *supra*, it may not claim the benefit of the income on which tax was paid.

With the decisions of the Tenth Circuit in the *Charles Ilfeld Company* case and that of the Second Circuit in the *Remington Rand* case before us let us assume that the other subsidiary of the Apartment Corporation, The Consolidated Apartment House Company, did during the prior years operate at a profit and that during the year 1926 the Apartment Corporation sold the stock of this subsidiary as well as that of the University

Homes Company. The question would then arise, how is the loss in the one instance and the gain in the other to be determined? If it is done as the respondent contends, the loss sustained on the disposition of the stock of the University Homes Company would be offset by prior year losses while on the other hand the gain derived on the sale of the stock of the Consolidated Apartment House Corporation would be included in its entirety. The result of such computation would certainly do more to distort income than does the decision of the Board of Tax Appeals in the case of the *Apartment Corporation*, 26 B. T. A. 849.

The question that is presented to the Court in these cases is not whether an isolated taxpayer may or may not obtain what appears to be a double benefit, but the question is, what is the proper method to be employed to determine the amount of the gain or the loss on the disposition of the stock of the subsidiary? To say that the same statutory provisions should be construed to establish a different rule for the determination of gain than that to be employed for the determination of loss appears to be altogether inconsistent and not supported by any provisions of the revenue acts. Congress defines net income as gross income less deductions and it was certainly not intended that a tentative computation should be made to determine whether there had occurred a gain or a loss before it should be decided which rule should be elected as applicable.

CONCLUSION.

The decision below ignores explicit statutory provisions and is founded on the fallacy that petitioner seeks to deduct a loss allowed as a deduction in prior years.

Respectfully,

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